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UNCLAS SECTION 01 OF 02 BISHKEK 000328

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SUBJECT: NEW KYRGYZ 2008 BUDGET ADOPTED

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**¶11.** (SBU) Summary: Kyrgyz President Kurmanbek Bakiyev signed the 2008 Kyrgyz budget into law March 17. The 2008 budget projects a 25% increase in revenues and 19% rise in expenditures over 2007 budget levels, with revenues reaching approximately \$1.1 billion and expenditures reaching almost \$1.2 billion. The government plans to cover the projected \$100 million budget deficit through privatizations and other measures. However, commodity price increases, growth in government spending and other factors are kindling inflation, which may reach 25-30% this year. A new tax code, which may include a reduction in VAT, is expected to be debated in the parliament this spring. End summary.

General Budget Overview

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**¶12.** (U) The Kyrgyz parliament, dominated by the pro-presidential Ak Jol party, adopted the 2008 state budget without the delays seen last year. President Bakiyev, while undergoing medical treatment in Germany, signed the legislation into law on March 17. Budget expenditures are expected to increase by 19% compared to 2007 figures, reaching \$1.177 billion or 27.3% of the projected GDP. (Note: Expenditures, which are growing at a faster rate than GDP, equaled 22.2% of GDP in 2006 and 25.6% of GDP in 2007. End note.)

**¶13.** (U) The 2008 budget outlines significant increases in salaries and services for education (up 29%), health (up 40.5%) and social protection (up 17%). Basic operating expenses of the government for 2008 are estimated at \$527.3 million. The salaries of civil and municipal servants will be raised (for the first time since 2000) by an average of 59%. (Note: The state budget is denominated in Kyrgyz som. We have converted budget figures using an exchange rate of 36.6 som/USD. End Note.)

**¶14.** (U) Budget revenues are projected at about \$1.1 billion, or 25% of projected GDP. Revenues are projected to increase 17% over 2007 budget targets, as the government forecasts significant growth in

tax and non-tax revenue. Kyrgyz data indicate that customs duties for 2008 are anticipated to reach \$511 million, amounting to nearly half of overall revenues.

#### Financing the Deficit

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**15.** (U) The projected \$97 million budget deficit (2.2% of GDP) is less than 2007's projected budget deficit. (Note: According to the IMF, the Kyrgyz 2007 consolidated budget deficit was only 0.4% of GDP, much less than original budget projections, due to higher than expected levels of revenue. However, the IMF also recently predicted a bigger deficit for 2008. End note.) The government plans to cover the projected budget deficit by selling government securities and non-financial assets, privatizing state property, collecting additional taxes and customs fees, and utilizing foreign grants. Specifically, the Kyrgyz government is aiming to privatize the largest electricity distribution company, "Severelectro," the Bishkek thermal power plant, the telecommunications giant "Kyrgyz Telecom," the natural gas transport and distribution firm "Kyrgyzgaz," and the rural customer-focused "Ayil Bank." However, problems affecting previous privatization attempts of Kyrgyz Telecom may also complicate these planned sales.

#### Adding Another Tier to the Budget

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**16.** (U) The 2007 budget, based on a two-tier budget system designed to decentralize government administration, allocated funds directly from the central budget to local administrations. However, the 2008 budget reintroduces funding to rayon (district) level administrations as well. This change may have no significant impact on the government's decentralization program unless rayon level budgets in future years expand beyond the limited scope envisioned in the new allocations.

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#### Innovations

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**17.** (U) For the first time, the 2008 budget law introduces budget projections, which are binding on Kyrgyz ministries, through 2010. This new approach envisions 2009 revenues and expenditures at \$1.454 billion and 2010 revenues and expenditures at \$1.594 billion.

#### Comment

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**18.** (SBU) Significant price rises for commodities, growth in Kyrgyz budgetary outlays and other factors over the past two years have kindled inflation, which is expected to reach 25-30% in 2008. The government's attempts to make the state budget more transparent and progressive could be aided by a revised tax code. The draft tax code, devised partially with the input of business associations, is expected to be debated in parliament this spring.